

Nexus Between Accrual Based Accounting and Financial Reporting Quality of Local Government Authorities in Nigeria.

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ABSTRACT

The call for greater transparency and efficiency in government reporting began long ago, but today has taken a new dimension. A combination of reasons ranging from increased public expectations from the government (in terms of service quality), dwindling oil revenue, need for more transparency and most importantly accountability in government financial reporting, have led to several financial reforms in public sector financial management globally. This study examined the relationship between accrual-based accounting and faithful representation, comparability and understandability of the financial statements (all proxies of financial statements quality) of Local government authorities in Nigeria. The study adopted the survey design. The population consisted of staff, accountants, auditors and other parties, who make use of financial reports of local government authorities in Nigeria. Data were collected through the questionnaire in the Rivers State of Nigeria and analysed using Pearson Product Moment Correlation. The study concluded that accrual-based accounting influenced quality of financial reports of local government authorities in Nigeria significantly and positively. It was recommended that the adoption of and seamless implementation of accrual-based financial reporting will ensure improved financial quality of the local government financial reports in Nigeria and should be encouraged.

KEYWORDS: *Accrual Accounting, Financial reporting, Local Government Authorities, Financial statements, Financial Quality*

1.0 INTRODUCTION

The focus of contemporary financial reporting today is to meet the information needs of those who use accounting information to make decisions, the government inclusive. These decision makers, (internal and external), rely on the financial reports prepared by the accountants to assess the financial position, financial performance and the changes that have taken place in the entity over time, as this forms the basis of their financial decisions. According to Udeh and Sokpekan (2015) Government accounting refers to its financial disclosure practices and financial information system.

Further, governments and their agencies are seen to be representatives of the people. As a result, they are expected to render accounts of their stewardship periodically to their citizens in the form of financial reports at both the Federal, State, and Local government levels. Aptly put, they prepare, and present financial reports used for decision making by various stakeholders interested in government financial reports. Characteristically, such financial statements are expected to be understandable, comparable and faithfully represent the true state of affairs of the financial transactions of the entity as the desire to make government to be more accountable has become more prominent and needful.

Before now, government accounting used to be cash-based, with its attendant negative consequences. Barret (2006) posits that the cash based financial reporting has the following demerits: full costs of departments are not well recorded; no records of government accrued expenses and liabilities; non-reporting of performance efficiency and performance measured based on budget compliance. Consequently, there has been growing need for an accrual based financial statements as against the cash based financial reporting system.

Due to the above lapses, and other identified pitfalls associated with the cash based approach, the Federal government of Nigeria, swiftly approved the migration to accrual based financial reporting called 'International Public-sector accounting standards (IPSAS)' effective 2012. The aim was to improve the quality of government reporting at all levels, leading to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability (Otunla 2015).

The Local government system is the third level of government and the closest to people at the grass root was not left out of the pronouncement. With a total of 774 local government authorities spread around the 36 states and Federal Capital Territory (FCT), the local authorities are charged primarily with constitutional responsibilities of provision of schools, markets, parks and some infrastructure to the citizens or residents. To do that, they embark on generating revenue internally as well as statutory allocations from the Federation Accounts as their major sources of finance. Regrettably, the local government system as important as they are, had been bedevilled with massive corruption and abuse of public office, gross mismanagements of funds, non-performance, abuse of accounting processes and procedures, inconsistency in accounting policies, non-uniformity of accounting principles, difficulty in comparability of accounts and lack of transparency in their financial statements. For those reasons, the directive by the federal government for the migration or adoption of IPSAS was not only a welcome development but also seen to be timely and apt.

Several studies have been carried out in the area of International Public-Sector Accounting Standards (IPSAS) and accrual based accounting. Antony and Pat (2014), Obara and Nangih (2017), Fracus (2010), Ijeoma and Oghoghomeh (2014) Olomiyete (2014), Otunla (2014) Udeh and Sokpekan (2015) and Udu (2013) have variously carried out several studies on IPSAS adoption in Nigeria. However, accrual based accounting and financial reporting quality of the local government authorities in Nigeria appear scanty in extant literature. Consequently, this constitutes a gap in knowledge and needs to be further addressed. Thus, this study explores this gap and empirically examines the relationship between the adoption of accrual based accounting and financial reporting quality of local government in the Rivers State of Nigeria. Specifically, it sought to address the following research objectives:

- i. Examine the relationship between accrual- based financial reporting and faithful representation of financial transactions of Local Government Authorities in Nigeria;

- ii. Determine the relationship existing between the adoption of accrual -based financial reporting and comparability of financial statements of Local Government authorities in Nigeria;
- iii. Assess the relationship between the adoption of accrual based accounting and understandability of financial statements of Local governments as the third tier of government in Nigeria.

It is believed that the study will assist local governments in Nigeria to increase their financial disclosures, accountability and further boost their compliance with IPSAS. It will also help users to rely on financial statements of local governments for reasons of credibility, comparability, and transparency.

2.0 LITERATURE REVIEW

The section deals with the review of relevant literature on accrual based accounting and financial statements quality. The theories backing the study and an overview of the workings of the Local Government Administration in Nigeria were also considered.

2.1 Theoretical Foundations

The study considers the stakeholders', agency, and the stewardship theories in its quest to drive home the point in this study. These are discussed below;

2.1.1 Stakeholder theory: Stakeholder theory stresses that management of organizations have a network of relationships to serve; and should strive to satisfy the needs of all the organization's stakeholders including; the employees, shareholders, suppliers, business partners and contractors. Developed by Freeman (1984), the theory disagrees with agency theory which advocates that there is contractual relationship between managers and shareholders; whereby the managers have the sole responsibility of maximizing shareholders' wealth. Stakeholder theorists consider the view that the agency theory was too myopic, as managers' actions impact other interested parties, other than shareholders. To ensure adequate protection of stakeholders' interest, stakeholder theory proposes the representation of various interest groups on the organization's board to ensure consensus building, avoid conflicts, and harmonize efforts to achieve organizational objectives (Donaldson and Preston,1995).

Relating the propositions of the stakeholder's theory to this study, the government and its agencies are seen to be managers of the nation's resources. By implication, they are expected to protect the interest of all stakeholders (those seen to be interested in the accounting information of the state, internally and externally).

2.1.2 Agency Theory: In accordance with the Agency theory, governments (executive, judicial and legislature), irrespective of the level, are representatives of the people. They are agents of the citizenry or tax payers, who in turn are their principals. They are, by law and as a matter responsibility, accountable to the people. They are expected to render stewardship reports in the form of timely, relevant, detailed, and reliable financial reports to the people who have either elected or appointed them to represent their interests. Aside the people, donor agencies also see the government or their agencies as their agents. They owe them financial reports, detailing how the amounts given to them were utilized.

2.1.3 Stewardship theory: Stewardship theory postulates that those charged with the responsibility of overseeing the affairs of organizations or institutions are motivated by a desire to achieve and gain intrinsic satisfaction by performing challenging tasks; hence, their motivation transcends mere monetary gains. Stewardship theory recognizes the need for

executives to act more autonomously to maximize the shareholders returns. Consequently, managers require authority and desire recognition from peers and bosses to effectively perform their tasks. Hence, shareholders must authorize the appropriate empowering governance structure, mechanisms, authority, and information to facilitate managers' autonomy, built on trust, to take decisions that would minimize their liability while achieving firm's objectives (Donaldson and Davis, 1991). Unlike agency theory, stewardship theory emphasizes the role of top management as stewards because they are expected to integrate their goals as part of the organization.

Relating the provisions of the stewardship theory to this study, the Local Government administrators are expected to render account of their stewardship to the people and other interested parties, on a periodic basis. These stewardship accounts are used for key financial decisions by the stakeholders.

2.2 Conceptual Overview

Accrual Based Reporting and Dimensions

As said earlier, the incessant demands for good governance have triggered off the need for reforms in public sector of the Nigerian economy, the local government inclusive. Good governance is evidenced by the effective financial and human resources management through an improved budgeting, accounting, and reporting, with emphasis on accountability, transparency and rooting out inefficiency particularly in public enterprises (World Bank, 2003 and 1992).

Nigeria's local government authorities considerably lacked all these, as the country's local government system is characterized by poor leadership with unlimited power, misuse of state resources, embezzlement, corruption, breakdown of law and order, to mention but a few. The country first embarked on various economic, institutional and functional reforms in 2003. The financial reforms required that government business should be transacted like in the private sector, in order to ensure transparency, accountability, efficiency and improved financial reporting and service delivery. Nigeria recently adopted the New Public Management program, which has been embraced by the public sector of most countries of the world. It advocates that the accrual basis accounting should be introduced in the public sector, as it is practiced in the private sector. In other words, Nigeria has embraced accrual accounting in the public sector financial and budget reforms. The primary purpose of accrual accounting in the public sector is to make the cost of running a government transparent, improve decision making processes and to hold government officials responsible for outcomes and outputs (Barret, 2006). Other benefits of accrual accounting in the public sector as summarized by Evans (1995) include: better measurement of costs and revenue, including comparisons between years; greater focus on outputs rather than inputs; more efficient and effective use of resources, full cost of providing a service can be compared with outside suppliers; better indication of the sustainability of government policy; improved accountability; better financial management system and greater comparability of management performance results.

Financial Statements Quality

Users need information to help them assess the performance and position of an entity in order to make useful decisions. They need credible financial information about the resources of the entity and the claims against the resources to know whether management have performed well in the discharge of their responsibilities. For that, financial statements must have certain fundamental qualities or attributes. These characteristics include: reliability, relevance, faithful

representation, understandability, verifiability, and comparability. These are also called fundamental and enhancing characteristics of financial reporting information.

Firstly, financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena but must faithfully represent the phenomena that it purports to represent. Hence financial information must be complete, neutral, and free from error.

Secondly, comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. By this we mean information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or date. Here, it should be noted that comparability is different from uniformity. Entities should change accounting policies if those policies become inappropriate. Corresponding information for preceding periods should be shown to enable comparison over time.

Lastly, by understandability, it means that financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyze the information diligently. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information on those phenomena might make the information easier to understand, but without it those reports would be incomplete and therefore misleading. Therefore, matters should not be left out of financial statements simply due to their difficulty as even well-informed and diligent users may sometimes need the aid of an advisor to understand information about complex economic phenomena.

2.3 Empirical Review

Ijeoma and Oghoghomeh (2014) examined the expectations, benefits and challenges of International Public Sector Accounting Standards in Nigeria. The study employed primary data and adopted the Kruskal Wallis test and descriptive analysis. The findings of the study reveal that IPSAS adoption increases the enhances comparability and International best practices.

Udeh and Sopekan (2015) examined the relationship between IPSAS adoption and quality of reporting in the public sector. Their findings revealed that the quality of financial reports would be improved through accrual based accounting.

Adoagye (2012), argued that accrual based accounting in the public sector enhances high quality of financial statements. Atu and Okoye (2013) stressed that Accrual based accounting would pave the way or harmonization of financial reports and improve financial statement comparability. Oduware (2012) argued that adoption of accrual based accounting will enhance comparability of financial statements through transparent and prompt presentation of financial information. On their part, Okoh and Ohwoyibo (2010), asserted that the adoption of accrual accounting will eliminate partial disclosure. They further argued that full representation will enhance the quality of financial reporting in terms of its contents, relevance and international competitiveness. Nongo (2014) encapsulates that accrual accounting in the public sector would enhance service delivery, support internal control and bring into focus the performances of the various units. He further argued that it will not only enhance credibility of reports but also build the confidence of Nigerians and development partners both within and abroad. He concluded that the introduction of accrual accounting in the local government would help to fight corruption, usually traced to lack of proper accounting system. Again Oulasvirta (2012) opined that with accrual based accounting and subsequent uniformity in reporting amongst

government units, comparability of Nigerian government financial statements with that of other countries would be carried out with ease.

2.2.3 Overview of The Local Government Administration

Oviasuyi et al (2010) posits that the local government administration in Nigeria has attracted serious attention both nationally and internationally since the great local government reform of 1976. He further argued that the Local government is the closest tier of government to the people of Nigeria, yet the resident population in it is denied the benefits of its existence. Thus the failure of local government in the area of service delivery over the years has made the citizens to lose faith and trust in local government administration as an institution in Nigeria.

There is a consensus of opinion that the local government is an important and inevitable unit seen as the grass root level of government whether in a federal or unitary arrangement. The form or structure or the tiers within the systems varies. In Nigeria, it operates a single tier, while in Britain, USA, France and India are multi tiers. The United Nations Division of Public Administration cited in Ola and Tonwe (2009) views local government as a political division of a nation which is constituted by law and that has substantial control of local affairs, including the powers to impose taxes or exact labour for prescribed purposes. Chukwuemeka et al. (2014), Otinche (2014), Ezeani (2012) Tumini (2011) note that local government has the following characteristics including a given territory and population, an institutional structure, a separate legal identity, has a range of powers and functions authorized by delegation from the appropriate central or intermediate legislature.

Development of Hypotheses

From the objectives of the study and the literature review above, the following hypotheses were formulated and tested:

H01: There is no significant relationship between accrual- based financial reporting and faithful representation of financial transactions of Local Government Authorities in Nigeria.

H02: There is no significant relationship between the adoption of accrual -based accounting and comparability of financial statements of Local Government administrations in Nigeria.

H03: There is no significant relationship between the adoption of accrual based accounting standards and understandability of financial statements of Local governments as the third tier of government in Nigeria.

3.0 METHODOLOGY

The study adopts a survey research design to obtained data from respondents. The survey research design was adopted because it provides the possibility of collecting needed information from a large number of respondents as well as its ability to use statistical tools to verify statistical implications. The target population was staff of Local Government Councils in Nigeria. However, due to the difficulty of conducting an effective study on the entire population, the researcher resorted to limit the study to an accessible population; being the Local government staff in Rivers State. The study used the judgmental/purposive sampling technique to select a sample size of 292 staff out of the 23 Local governments of Rivers State and relied on primary sources for data mainly collected through the questionnaires titled “Accrual based accounting and financial reporting quality in Nigeria”. Statistical analysis was carried out on the resulting data.

The study employed the descriptive statistical tools for analysis as well as Pearson product moment correlation statistical tools to examine the relationship between the independent and dependent variables, via the SPSS platform. Equally, the Cronbach's alpha was used to test the measures for reliability. As a rule, a coefficient that is equal to or greater than 0.5 is an indication of a good construct and can therefore be accepted. The Cronbach's alpha as derived from SPSS platform indicated that for Accrual based accounting and faithful representation of government financial statements, the coefficient was 54.0%, for Accrual accounting and Comparability of financial reports, the coefficient 73.0%, and for Accrual accounting and understandability of government financial reports, the coefficient was 71.1%, The various outcomes of the reliability test indicated the extent of consistency of the scales and questions presented to the respondents as well as their reliability.

Finally, the research instrument was subjected to content and construct validity achieved through peer vetting, and assessment by knowledgeable professionals on the subject area.

4.0 ANALYSIS OF DATA

Descriptive Statistics of the dimensions of accrual accounting basis and financial statement quality

	N	Minimum	Maximum	Mean	Std. Deviation
AAB	292	2.67	4.67	4.0424	.49297
FAR	292	2.00	4.67	4.0242	.59440
UND	292	3.00	5.00	4.0121	.49259
COM	292	2.33	4.67	3.8182	.51647
Valid N (listwise)	292				

The outcomes of the descriptive statistics of the mean and the standard deviation for the independent variable; accrual accounting as well as the dependent variables; faithful representation, understandability and comparability of financial statements are shown on Table 4.1. From the table, accrual accounting basis (AAB) has a mean and standard deviation of 4.0424 and 0.49297 respectively. Furthermore, the figures for accrual accounting basis range from a maximum of 4.67 to a minimum of 2.67 for the different categories of the values. Faithful representation reported a mean of 4.0242 and a standard deviation of 0.59440. It has a maximum and minimum figures ranging from 4.67 to 2.00. understandability of financials has a mean and standard deviation of 4.0121 and .49259 respectively. The figures range from a minimum of 3.00 to a maximum of 5.00. In the same vein, the mean and standard deviation of comparability of financial statements are 3.8182 and 0.51647 respectively with figures ranging from 4.67 maximum to 2.33 minimum.

HO₁: *There is no significant relationship between accrual- based financial reporting and faithful representation of financial transactions of Local Government Authorities in Nigeria.*

4.1 Correlations between accrual accounting basis and faithful Representation of financial statements

		AAB	FAR
AAB	Pearson Correlation	1	.804**
	Sig. (2-tailed)		.000
	N	292	292

FAR	Pearson	.804**	1
	Correlation		
	Sig. (2-tailed)	.000	
	N	292	292

** . Correlation is significant at the 0.01 level (2-tailed).

From the table above, a positive and very strong significant relationship exists accrual accounting basis and faithful representation as a quality financial statement. This is denoted by the correlation coefficient of 0.885** at a probability value of 0.000 ($p = 0.000 < 0.05$). The implication is that the adoption of accrual based accounting methods by Local governments in Nigeria significantly enhances the completeness, neutrality and freedom from material errors of financial statements. This ensures that financial statement faithfully and truly represents the financial transactions that had occurred during the accounting period. The result of this test has confirmed the claims of Ijeoma and Oghoghomeh (2014). In the light of that, this study is significant in justifying the influence of accrual based financial accounting on faithful representation of local governments' financial reports in Nigeria.

HO₂: *Adoption of accrual -based accounting and comparability of financial statements of Local Government administrations in Nigeria.*

4.2 Correlations between accrual accounting basis and comparability of financial statements

		AAB	COM
AAB	Pearson	1	.869**
	Correlation		
	Sig. (2-tailed)		.000
	N	292	292
COM	Pearson	.869**	1
	Correlation		
	Sig. (2-tailed)	.000	
	N	292	292

** . Correlation is significant at the 0.01 level (2-tailed).

The outcome of the Pearson product moment correlation as shown on the above table reveals that the coefficient of determination of the relationship between accrual based accounting and comparability of financial statement is 0.869 at an alpha or probability value of less than 0.05 ($p_v = 0.000 < 0.05$). The result indicates a positively significant relationship between both variables. Based on that we reject the null hypothesis and accept the alternative hypothesis. The significant relationship implies that most of the variables used in the model are supported and an increase in application of accrual based accounting methods significantly promotes comparability of financial reports of different entities or different period of the same entity. Comparability of financial occasioned by the adoption of accrual based accounting the government departments enables the users to evaluate the performance trend of a reporting entity by matching its financial reports for different reporting periods.

The result of this study has reinforced the claims of Alao et al (2015). In the light of that, this study is significant in justifying the influence of accrual based financial accounting on comparability of financial reports of local governments authorities in Nigeria.

HO₃: *There is no significant relationship between the adoption of accrual based accounting and understandability of financial statements of Local governments as the third tier of government in Nigeria.*

4.3 Correlations between accrual accounting and understandability of financial Statements

		AAB	UND
AAB	Pearson Correlation	1	.964**
	Sig. (2-tailed)		.000
	N	292	292
UND	Pearson Correlation	.964**	1
	Sig. (2-tailed)	.000	
	N	292	292

** . Correlation is significant at the 0.01 level (2-tailed).

The results of Pearson product moment correlation as shown on the table above indicates that the coefficient of determination is 0.964** at a significant or probability value of less than 0.05 ($p_v = 0.000 < 0.05$). Consequently, we reject the null hypothesis and accept the alternative hypothesis, which indicates that there is a significant relationship between accrual-based accounting and understandability of financial reporting of local governments in Nigeria. This indicates a positive and very strong significant relationship between accrual based accounting and the understandability of financial statements by the end users. The positively significant relationship implies that an increase in the use or application of accrual based accounting in the preparation and presentation of financial statements significantly enhances the understandability of such statements by users of financial statements. Furthermore, the correlation outcome indicate that the application accrual accounting methods promote clarity in the presentation of financial statement in such manners that users can easily comprehend the content information and take economic decision thereon. The result of this study agrees with the findings of Oviasuyi et al (2010) and that of Obara and Nangih (2017).

5.0 DISCUSSION OF FINDINGS

In this study, three hypotheses were tested. For the first hypothesis, it was discovered that there exists a significant relationship between accrual based accounting and faithful representation of financial transactions of Local Government Authorities in Nigeria. From the statistical test of hypothesis one in which a positive correlation value of 0.804 was revealed thus establishing a significant relationship between the accrual based accounting and the faithful representation of financial statements in the Nigerian Local Government financial reporting.

The second hypothesis attempted to examine the relationship between adoption of accrual based financial reporting and the comparability of financial statements or reports of the Local government authorities. The correlation result showed a coefficient of 0.869. This means there exists a significant positive relationship between adoption of accrual based accounting and the comparability of financial reports of the local government authorities. As such, we reject the null hypothesis and accepted the alternative one.

The hypothesis three examined the relationship between the adoption of accrual based International Public-sector accounting standards and understandability of financial statements of Local governments as the third tier of government in Nigeria. The outcome of the statistical test of relationship revealed there exist a strong positive significant relationship between accrual based accounting and understandability of local government financial statements in Nigeria. With a correlation coefficient of 0.964, we reject the null hypothesis which states that

there is no significant relationship between the independent and the dependent variables. Thus, we accept the alternative hypothesis.

6.0 CONCLUSION AND RECOMMENDATIONS

This study examined the implications of accrual based financial reporting by local government entities in Nigeria. It was concluded that accrual-based accounting will significantly improve financial reporting quality of local government accounting in Nigeria. Thus, the following recommendations were made;

- 1) that government should ensure all local councils in Nigeria adopt and implement the accrual based financial reporting system, that is the International Public-Sector Accounting Standards (IPSAS).
- 2) The Financial Reporting Council of Nigeria and other regulators should be more proactive in the monitoring of the accounts prepared by Local governments to ensure they are IPSAS compliant
- 3) Office of the Auditor General and the Internal Audit units of the various Local government should be strengthened to ensure efficiency in the discharge of their statutory functions
- 4) more sensitization workshops are carried out for stakeholders as well as procurement of IPSAS related materials and training of identified stakeholders,
- 5) conduct gap analysis of areas and states/local governments where necessary, collaborate with the World Bank and other development partners, issuance of circulars to ensure compliance by public sector entities, particularly the local government authorities
- 6) provide robust integrated ICT framework for IPSAS adoption and implementation.
- 7) Finally, we recommend the amendment or review of financial regulations, Treasury Manuals and Circulars, Financial instructions of states and Financial Memoranda of Local Governments into one public financial management regulations to ensure uniformity and seamless adoption and implementation nationwide

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